

DEPARTMENT OF SOCIAL SERVICES

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October 4, 1985

ALL-COUNTY INFORMATION NOTICE I-76-85

TO: ALL COUNTY WELFARE DIRECTORS
ALL COUNTY FISCAL OFFICERS
ALL COUNTY AUDITORS
ALL COUNTY ADMINISTRATIVE OFFICERS

SUBJECT: FEDERAL REIMBURSEMENT POLICIES FOR COSTS OF SPACE

As counties are aware, the State Controller's Office (SCO) was delegated the responsibility to review and approve space-related expenditures for the Federal Government effective with Fiscal Year 1980/81. This delegation of authority included the responsibility to develop and release information to supplement existing space cost plan release instructions.

Currently the SCO, County Cost Plans Bureau is in the process of developing new guidelines for the application of space cost principles based upon the current federal policies. These guidelines, once reviewed and approved by the Federal Government, will be published in Chapter 3100 of the SCO Handbook of Cost Plan Procedures for California counties. The Handbook has been developed to fill an existing void between cost principles for local departments as set forth by the Federal Government and the application of those principles by California counties. The Handbook contains the latest policies and procedures on the preparation and application of countywide cost allocation plans and is designed to be used in conjunction with the Office of Management and Budget Circular A-87 and Publication OASC 10, issued by the Department of Health and Human Services. The Handbook has been distributed to County Auditors and other parties involved in countywide cost plan preparation.

Until the SCO space guidelines are approved by the Federal Government, the State Department of Social Services (SDSS) will not be updating Section 25-829 of the Manual of Policies and Procedures. In the meantime, as a result of numerous inquiries received from welfare departments concerning the reimbursement of space costs, SDSS, in conjunction with the SCO, has prepared the following question-and-answer discussion. This discussion addresses the major points of Federal reimbursement policies. State guidelines as a general rule follow those of the Federal Government, especially for agencies receiving funding from the Department of Health and Human Services.

Question-and-Answer Discussion

1. WILL THE FEDERAL GOVERNMENT PARTICIPATE IN THE UP-FRONT FUNDING FOR BUILDING ACQUISITION OR CONSTRUCTION?

Generally no. For ongoing programs which are Federally sponsored through

formula grants or discretionary grants without construction authority, Federal grant funds cannot be used to acquire a building outright. Grant program funds can be used for the necessary and reasonable cost of occupying space on an annual basis.

2. HOW WILL THE COSTS OF A COUNTY-OWNED BUILDING BE REIMBURSED?

For county-owned buildings, and buildings acquired under certain leasing arrangements, the county may claim for reimbursement an annual use allowance based on 2 percent of the acquisition cost of the building. Actual reimbursement will be based on the reimbursement ratios used by the various grantor agencies.

3. WHAT IS A USE ALLOWANCE?

A use allowance is the Federal Government's method of recognizing the cost of acquiring and occupying a building without requiring formal depreciation records. The annual use allowance is computed at a rate of 2 percent of the building's acquisition cost and is claimed annually for as long as the building is occupied by the grant program. If the building's acquisition cost is not known because of the loss of historical records, a reasonable estimate can be developed. If a building was acquired through a donation, the fair market value of the building at acquisition date can be used provided the Federal Government did not finance any part of the construction cost of the building.

4. CAN A COUNTY DEPRECIATE ITS BUILDINGS?

Yes, but the Federal Government requires a singular reimbursement treatment for all assets in a single class. Since general purpose office structures are viewed as a single class of assets, they all must be claimed either through depreciation or use allowance. A combination of the two methods may not be used within a single class of assets.

5. WHAT ABOUT THE COST OF LAND?

The costs of land, and all costs associated with acquiring or financing land, are unallowable for reimbursement under the cost principles.

6. WHAT IS THE DIFFERENCE BETWEEN DEPRECIATION AND A NEGOTIATED SPECIAL AGREEMENT?

Depreciation, or use allowance in-lieu of depreciation, is allowed under Sections B.11 and C.2 of the A-87 Cost Principles. Special agreements constitute an accelerated reimbursement of acquisition cost which is negotiated with the grantor agency. This negotiation is provided for in Section C.3 of the A-87 Cost Principles and constitutes a separate type of space approval. For claiming purposes, the use of a special agreement for one building and use allowance for all other buildings does not violate the single class of assets rule.

7. CAN SPECIAL AGREEMENTS STILL BE NEGOTIATED WITH THE FEDERAL GOVERNMENT?

Because of the restrictions and controls placed on approvals in which the Federal Government acquires equity in a facility, there is a reluctance to enter into such a negotiated agreement. However, in certain instances the capital expenditure method can be utilized to claim the costs of a new building. In light of recent changes in the cost principles which allow for the reimbursement of interest expense in financing a building, it is hoped that requests to use the capital expenditure method will be minimized.

8. WHAT IS THE CAPITAL EXPENDITURE METHOD?

Using this method, the Federal Government and a county negotiate the reimbursement of a new building over a specified period of time. The reimbursement period may be significantly shorter than the useful life of the building, but it is assumed that the grant program will occupy the building over its entire useful life.

9. ARE THERE ANY CONDITIONS FOR USE OF THE CAPITAL EXPENDITURE METHOD?

There are several. First, use of this method of reimbursement requires the approval of the Federal Government prior to acquisition or construction. Second, the building must be used predominantly by Federally sponsored public assistance programs and accomplishment of program objectives must require the building on a long term basis. Third, the building must not be currently owned by the county or occupied under a lease having the characteristics of ownership. Fourth, the use of this method must produce a substantial savings in cost over the alternative means of financing and claiming the building.

10. HOW MUCH SPACE MUST BE OCCUPIED BY FEDERAL PROGRAMS IN ORDER TO USE THE CAPITAL EXPENDITURE METHOD?

At least 75 percent of the net usable square feet of the building must be occupied by Federally financed public assistance programs. The remaining square footage can be occupied by non-federally sponsored programs, but only the prorated share of costs for welfare can be claimed against Federal grants on the administrative expenditures claim.

In the case of a building being totally occupied by federally sponsored programs, only the prorated share of costs for welfare can be claimed on the administrative expenditures claim.

11. HOW MUCH TIME IS REQUIRED IN SECURING A CAPITAL EXPENDITURE APPROVAL AND WHAT AGENCIES ARE INVOLVED?

All correspondence on such a proposal will be directed through the State Controller's Office, Bureau of County Cost Plans. The Bureau will coordinate the concurrence of the State Department of Social Services and the approval of the Federal Department of Health and Human Services. A good time estimate for approval would be three to six months. Proposals for grants other than public assistance will not be entertained.

12. CAN'T A COUNTY JUST CLAIM THE ACTUAL LEASE PAYMENTS ON A BUILDING FOR REIMBURSEMENT?

If the building lease is truly an operating lease in which the county is not acquiring any equity or ownership in the building, then the lease payments can be claimed for reimbursement provided they do not exceed comparable rental rates.

If the lease agreement is a sale-and-leaseback arrangement, a less-than-arms-length lease, or a material equity lease, the lease payments are not eligible for reimbursement. Occupancy costs under these arrangements must be claimed as county-owned space, i.e., depreciation or 2 percent use allowance.

13. WHAT IS A MATERIAL EQUITY LEASE?

The Federal guidelines on material equity leases essentially follow those in Financial Accounting Standards Board (FASB) Statement 13 covering Capital Leases. First, the lease must be non-cancellable, or cancellable only on a remote contingency, e.g., non-appropriation of the annual lease payment in the budget. If this condition is met, then the existence of any one of the following will constitute a material equity lease:

- a. The county has the right to purchase the property for a bargain option price during the lease. The bargain exists if at the beginning of the lease the option price appears to be substantially less than the probable fair market value at the time the option to purchase can be exercised.
- b. Title to the property passes to the county during or after the lease period.
- c. The term of the lease (initial term plus periods covered by bargain renewal options, if any) is equal to or exceeds 75 percent of the economic life of the building.

14. HOW CAN THE COSTS OF A MATERIAL EQUITY LEASE BE CLAIMED?

A building acquired under a material equity lease must be claimed as a county-owned building. This implies the use of the 2 percent use allowance annually. In addition, the actual interest costs paid or accrued by the county in the lease may be claimed as well, provided the building is acquired or constructed on or after October 1, 1980. The claiming of interest expenses under this concept is through the Rental Rate System.

15. WHAT IF A NON-PROFIT PUBLIC FACILITIES CORPORATION ISSUES LEASE-REVENUE BONDS TO ACQUIRE A NEW BUILDING, THEN LEASES THE BUILDING TO THE COUNTY ON A LEASE-PURCHASE BASIS?

In this case the acquisition cost paid for the building by the public facilities corporation would be claimed by the county using the annual 2 percent use allowance. In addition, the annual interest expense paid or accrued on the

bond issue would also be claimed by the county. Issuance costs would be amortized on a straight line basis over the life of the issuance financing period and claimed as well. The claiming of interest expenses under this concept is through the Rental Rate System.

16. WHAT IS A RENTAL RATE SYSTEM?

A rental rate system is a concept developed to compare space occupancy costs to the rental costs of a comparable private sector building. A rental rate system is any system of accumulating actual costs of building occupancy on an annual basis and converting them to a monthly cost per square foot for comparison purposes.

17. ARE THERE ANY CAPS OR CEILINGS ON CLAIMING SPACE COSTS?

Yes. Whether in a privately or publicly owned building, allowable space costs cannot exceed the rental cost of comparable space in a privately owned building in the same locality.

18. WHAT IS A COMPARABLE RENTAL RATE?

This would be the rate charged for a non-county owned building in a location suitable to the grantee program and similar in size, construction, and cost per square foot (adjusted to exclude maintenance, utilities, taxes, and other costs where appropriate). Three comparable rents are required for comparison purposes, and the building selected must be within or lower than the rates compared. The existence of a comparable rent significantly higher than others in the same locality would not have a bearing on the claiming since it is treated as an aberration and excluded from the comparable rental study.

19. IS THE FEDERAL GOVERNMENT ACTIVELY INVOLVED IN APPROVING A NEW BUILDING LOCATION?

As in any other overhead cost, the cost of space is eligible for claiming provided it is both necessary and reasonable for the proper and efficient administration of the grant program. Generally, reliance is placed upon the Board of Supervisors and local policies to determine what is reasonable and necessary in the acquisition of a capital asset. However, each grantor agency retains the right to make the final determination concerning what is "necessary and reasonable" or "proper and efficient".

20. WHEN, IF EVER, WOULD A PAYBACK OF SPACE COSTS CLAIMED BE REQUIRED?

A payback of space costs claimed in excess of those earned is referred to as an abatement. An abatement is required only under a special agreement or capital expenditure approval when the grant program does not stay in the building for its entire useful economic life. An abatement is not required when a building is claimed using a 2 percent use allowance, depreciation, or rental rate.

21. HOW ARE THE COSTS OF UTILITIES, JANITORIAL AND MAINTENANCE CLAIMED?

These costs are claimed as annual operating costs provided they are not already included in rental agreements.

22. HOW ARE THE COSTS OF ALTERATIONS AND IMPROVEMENTS CLAIMED?

The reimbursement policies for these types of costs will be covered in the State Controller's Guidelines for Grant Reimbursement of Space Costs, Chapter 3100. Until the release of the Chapter, questions should be directed to the Bureau of County Cost Plans.

23. WHAT IS THE ROLE OF THE STATE CONTROLLER'S OFFICE IN REIMBURSING SPACE COSTS?

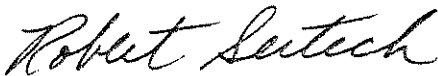
Acting as cognizant agency for the approval of all countywide overhead costs, it is the responsibility of the State Controller's Office to recommend and approve the reimbursement method for a building once it is acquired by a county for use by a county department. As for all overhead costs that relate to a grant program, the State Controller's approval does not guarantee actual reimbursement, since this is contingent upon the availability of funds from each grantor agency.

24. WHERE CAN FURTHER INFORMATION ON SPACE COSTS BE FOUND?

Further information can be obtained by writing to the State Controller at:

Bureau of County Cost Plans
P. O. Box 1019
Sacramento, CA 95805-5876
(916) 445-5153

The SCO coordinates welfare department space requests with SDSS. Therefore, questions can continue to be addressed to the SDSS Fiscal Policy and Procedures Bureau at (916) 445-7046.



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Administration

cc: CWDA